Decision 12-12-002 December 20, 2012

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

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| Order Instituting Rulemaking to Establish Policies and Cost Recovery Mechanisms for Generation Procurement and Renewable Resource Development. | Rulemaking 01-10-024 (Filed October 25, 2001)<br><br>(Petition for Modification Filed November 16, 2011) |

# DECISION GRANTING PETITION OF SAN DIEGO GAS & ELECTRIC COMPANY (U902E) FOR MODIFICATION OF DECISION (D.) 04-06-011 (AS MODIFIED BY D.06-02-031 AND D.06-09-021) REGARDING OTAY MESA ENERGY CENTER

San Diego Gas & Electric Company (SDG&E) filed this Petition for Modification of Decision (D.) 04-06-011 (as modified by D.06-02-031 and D.06-09-021), the decision approving SDG&E's Power Purchase Agreement (PPA or Otay Mesa PPA) with Otay Mesa Energy Center, LLC (OMEC), a wholly-owned subsidiary of Calpine Corporation. SDG&E requests that the Commission find reasonable and approve the suggested language clarifying that (1) SDG&E is responsible for the Otay Mesa Energy Center plant's[1] (Otay Mesa or Otay Mesa plant) greenhouse gas compliance obligation attributed to SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant; (2) any allowances allocated to OMEC will be

[1] OMEC owns and operates the Otay Mesa plant.

applied toward OMEC's compliance obligation; and (3) all SDG&E costs under the PPA will be recoverable in rates.

## 1. Overview

In Decision (D.) 04-06-011, we approved a ten-year Power Purchase Agreement (PPA) between San Diego Gas & Electric Company (SDG&E) and Otay Mesa Energy Center, LLC (OMEC) for the Otay Mesa plant as part of a motion by SDG&E for approval of a number of electric resources that were chosen following a request for proposal (RFP). The Otay Mesa plant is a 583-megawatt natural-gas-fired combined-cycle power plant in southern San Diego County. The Otay Mesa PPA was modified on two subsequent occasions, first on rehearing by D.06-02-031, which found the ten-year Otay Mesa PPA between SDG&E and OMEC to be reasonable, and later by D.06-09-021, which noted that the PPA had been modified to include Put and Call Options, which give SDG&E the opportunity to own and operate the plant with a 30-year useful life following the expiration of the ten-year PPA.

SDG&E filed this Petition for Modification (PFM) to modify the three previous Commission decisions approving the Otay Mesa PPA to clarify that OMEC's greenhouse gas (GHG) responsibilities, attributed to SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant, will be allocated to SDG&E, and any allocation of GHG allowances received by OMEC will be used to meet OMEC's GHG compliance obligation. This PFM is unopposed.

SDG&E asserts that a clear allocation of GHG responsibilities was not specifically included in the original PPA or any of the subsequent PPA modifications.

On October 20, 2011, the California Air Resources Board (CARB) adopted the final rules for a GHG cap-and-trade program.[2] The program's initial compliance obligation period will commence on January 1, 2013 with the first auctions of allowances beginning in late 2012.[3] As it currently reads, the Otay Mesa PPA does not specifically address which party – SDG&E or OMEC – will be responsible for GHG costs. Before CARB's cap-and-trade system compliance obligations commence on January 1, 2013, the parties desire contractual clarity regarding how the GHG responsibilities will be allocated between the parties so that the operation and finance of the Otay Mesa plant continues smoothly, without interruptions.

## 2. Background

In D.04-06-011, the Commission approved a motion filed by SDG&E to enter into several new electric resources contracts, including one for OMEC. These contracts were the result of an RFP issued by SDG&E to solicit bids to procure energy to meet its short-and long-term grid reliability needs. The Utility Reform Network (TURN) and Utility Consumers' Action Network (UCAN) filed a joint application for rehearing, challenging SDG&E's choice of the Otay Mesa plant as a winning bidder in the RFP. TURN and UCAN alleged that the Otay Mesa plant was not selected as a least cost/best fit resource from the RFP to meet the utility's grid reliability, but instead was selected to meet SDG&E's needs outside the scope of the RFP.

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[2] CARB, California Air Resources Board Adopts Key Element of State Climate Plan, October 20, 2011, available at http://www.arb.ca.gov/newsrel/newsrelease.php?id=245.

[3] California Environmental Protection Agency, Overview of ARB Emissions Trading Program, available at http://www.arb.ca.gov/newsrel/2011/cap_trade_overview.pdf.

In D.06-02-031, the Commission approved *de novo* on rehearing SDG&E's request for authorization to enter into a ten-year PPA with OMEC for Otay Mesa. The Commission found that the Otay Mesa PPA, when viewed as a bilateral contract and not as a winning bid in the RFP, was reasonable and provides benefits to SDG&E's ratepayers.

On December 20, 2005, after the Commission conducted evidentiary hearings on the rehearing phase for the Otay Mesa PPA, but before the Commission issued its decision on rehearing, Calpine Corporation (Calpine) and many of its affiliates and subsidiaries (but not OMEC) filed voluntary petitions to restructure under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York, Case #05-60199. In light of Calpine's bankruptcy, OMEC and SDG&E entered into discussions in February 2006 to again modify the Otay Mesa PPA to address the changed financial circumstances. Most significantly, the parties discussed ownership and operating options for the Otay Mesa plant. On June 14, 2006, OMEC and SDG&E reached an agreement whereby the Otay Mesa PPA would be modified to include Put and Call Options, which give SDG&E an ownership option following the expiration of the ten-year PPA.

After reaching an agreement with OMEC, SDG&E continued to negotiate with the other stakeholders – TURN, UCAN, and the Division of Ratepayer Advocates (DRA) – and on July 3, 2006, with the support of TURN, UCAN, and DRA, SDG&E filed a joint PFM of D.04-06-011 and D.06-02-031. In the resulting D.06-09-021, the Commission found that the Revised Otay Mesa PPA accomplished "the primary objectives of SDG&E which is to preserve and

improve upon the terms of the original PPA and get a state-of-the-art generation facility built in its service territory."[4] In addition, the revised PPA gave "SDG&E a cost-effective, local area reliable resource, with a lower long-term cost to the utility's ratepayers than the original PPA."[5] Finally, adding the Put and Call Option "create[d] the opportunity for SDG&E to obtain the plant at a fair and reasonable price after the expiration of the ten year PPA."[6]

According to SDG&E, new modification to the Otay Mesa PPA is needed now that the California GHG cap-and-trade program has been finalized. Once the program compliance begins on January 1, 2013, entities that emit more than 25,000 metric tons of carbon dioxide per year, such as OMEC, will have an obligation to acquire allowances in an amount equal to their emissions.[7] At the same time, CARB will provide an allocation of allowances of over 6.9 million metric tons to SDG&E on behalf of its customers that it must place into the CARB auction in 2012 and 2013.[8] This is the subject of the GHG proceeding. When it decided the level of allowances to allocate to SDG&E, CARB assumed that SDG&E customers would be paying for compliance costs for all fossil generation, including the generation of OMEC, either directly or indirectly. In anticipation of these imminent events, SDG&E filed this motion to modify D.04-06-011 (as

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[4] D.06-09-021 at 4.

[5] D.06-09-021 at 2.

[6] D.06-09-021 at 4.

[7] See CARB, Article 5, current as of September 12, 2011, available at http://www.arb.ca.gov/regact/2010/capandtrade10/2ndmodreg.pdf.

[8] See CARB, Appendix A, posted on July 25, 2011, available at http://www.arb.ca.gov/regact/2010/capandtrade10/candtappa2.pdf.

modified by D.06-02-031 and D.06-09-021) by clarifying the current Otay Mesa PPA to provide contractual clarity concerning OMEC's GHG allowance costs.

## 3. New Facts in Support of the Petition for Modification

Pursuant to Rule 16.4(b), the supporting Declaration of Matt Burkhart is attached to the PFM as Attachment 1. In his declaration, Mr. Burkhart provides the details and circumstances associated with the new facts in support of the PFM. A summary of these new facts is provided below.

### 3.1. The Recent Enactment of California GHG Cap-and-Trade Rules Demands PPA Modifications to Ensure Certainty for Ratepayers and Contracting Parties

After a year of legal limbo, CARB's cap-and-trade program and its final rules have finally been adopted. On August 24, 2011, CARB reaffirmed its commitment to implement its Scoping Plan, including cap-and-trade regulations in California, which will put into practice the California Global Warming Solutions Act of 2006, commonly known as Assembly Bill (AB) 32. According to the final program rules adopted by CARB on October 20, 2011, the initial compliance obligations will take effect on January 1, 2013, with the first auctions of allowances beginning in late 2012. Therefore, the parties have chosen to clarify their current contracts to ensure that when the cap-and-trade system goes into effect, they will have contractual certainty regarding the costs of compliance and the acquisition and usage of any allowances, offsets, or credits.

SDG&E and OMEC have a mutual desire to clarify the Otay Mesa PPA to ensure contractual certainty for themselves and ratepayers in future business planning. SDG&E and OMEC have agreed that SDG&E should be responsible for acquiring allowances on behalf of Otay Mesa GHG in a beneficial holding arrangement, and that if OMEC receives any allocation of allowances,

said allowances would be applied towards OMEC's GHG compliance obligation.[9] The parties signed a letter agreement clarifying the PPA on September 21, 2011 for this purpose.[10] The letter agreement would become effective with Commission approval.

Therefore, the parties request that the Commission allow them to proceed with the Otay Mesa PPA contractual modification. The parties' proposed modifications insert a new provision into the Otay Mesa PPA which allocates OMEC's GHG compliance obligations to SDG&E for SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant, while providing that any allocation of GHG allowances received by OMEC will be used to satisfy OMEC's GHG compliance obligation.

### 3.2. Centralizing OMEC's GHG Compliance Obligation with SDG&E Benefits Ratepayers

In its allocation of GHG allowances to electric utilities, CARB provides SDG&E with an amount equivalent to its expected compliance obligation, including the emissions associated with OMEC generation.

The proposed language would compensate OMEC for actual GHG costs associated with its emissions up to a limit, akin to what was done in the

[9] Under the cap-and-trade program, generators have responsibility for GHG compliance. Subarticle 5 of the cap-and-trade regulation allows other entities to act as an agent for the generator in acquiring allowances as long as that relationship is disclosed to CARB. When SDG&E acquires allowances for OMEC, it will inform CARB, who will in turn inform Calpine. Within one year, SDG&E must transfer the allowances to Calpine for OMEC's compliance obligation.

[10] September 21, 2011 Letter Agreement between OMEC and SDG&E (Appendix A to this decision).

AB 1613 (Stats. 2007, Ch. 713) contracts.[11] The proposed language would also put OMEC's GHG compliance obligation into the hands of SDG&E. SDG&E argues such an arrangement makes sense for both SDG&E and its ratepayers, in SDG&E's opinion. First, SDG&E is bidding OMEC electricity into California Independent System Operator (CAISO) markets. SDG&E's bid submission sets the criteria for the CAISO to decide how much OMEC will run, which in turn, determines the amount of GHG emissions the plant produces. Second, OMEC is more efficient than the marginal generator in almost any hour it is running.[12] Therefore, paying for actual emissions up to a limit based on the guaranteed heat rate of the Otay Mesa plant will be less expensive for ratepayers than paying market prices because market prices pay for GHG based on the marginal generator. Third, SDG&E will have the expertise to control the risks and costs of its portfolio of GHG allowances (including those from OMEC) because it will have to acquire allowances for its own generation.[13] Finally, by streamlining the

[11] There are two primary ways for a purchaser to compensate a generator for the GHG costs. One way would be to pay market rates for the power. Because GHG allowance costs will be embedded in the market price, this approach would compensate the generator based on the market price. This approach was taken for the renegotiated contracts with combined heat and power facilities in the QF Settlement, adopted in D.10-12-035. Another approach is to compensate the seller for actual GHG costs incurred up to a limit, as was done for new AB 1613 contracts, adopted in D.11-04-033.

[12] It would not be more efficient if it was the marginal resource.

[13] SDG&E has filed its GHG procurement plan with the Commission in the Long-Term Procurement Planning proceeding. R.10-05-006 (SDG&E Testimony, Ryan Miller).

GHG management, SDG&E will minimize the administrative costs of acquiring GHG allowances.[14]

### 3.3. Putting OMEC's GHG Compliance Obligation in SDG&E's Hands Is Consistent with SDG&E's and California Utilities' Current Approach to GHG Costs

The modified language presented by the parties is consistent with California Public Utilities' treatment of GHG allowances and associated costs. For example, the modified language presented herein was derived from SDG&E's form PPA that has been recently approved by the Commission in its Wellhead Margarita (now El Cajon) and JPower Orange Grove contracts.[15] Other California public utilities, such as Southern California Edison, currently use form contracts that similarly allocate the GHG allowances and their associated responsibilities to the utilities.[16] Therefore, our approval of the proposed language would make the Otay Mesa PPA consistent with other PPAs entered into by SDG&E and other California utilities.

The timing of the contract's execution is the primary factor supporting our approval of the PFM. If the materiality of GHG costs had been foreseeable, the

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[14] SDG&E has requested funding for two persons to manage GHG portfolio costs and compliance in its General Rate Case. Application (A.) 10-12-005 (SDG&E Testimony, Sue Garcia).

[15] D.09-12-026. SDG&E is using the same Commission-approved language in its proposed Escondido Energy Center, Pio Pico Energy Center, and Quail Brush Power PPAs, all of which are currently awaiting Commission action. A.11-05-023 (filed May 23, 2011).

[16] *See*, e.g., Southern California Edison, Energy Only Toll (zip file), available at http://www.sce.com/EnergyProcurement/ESM/AllSourceRFO/all-source-rfo.htm. SDG&E derived its GHG language from Edison's form contract.

associated risk to the facility would have been factored into the price of the contract and/or other contractual terms. However, given the timing of this contract, which was executed in 2004, allowing the contract to be modified such that the GHG costs are passed through to SDG&E would be reasonable. This outcome may better align dispatch decisions for this facility with the cap-and-trade regime. However, had this contract been executed after AB 32 was amended to include language regarding broad limits on GHG emissions (see AB 32 as amended on August 15, 2005; http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_0001-0050/ab_32_bill_20050815_amended_sen.pdf), it would be less appropriate to allow these costs to be passed through as proposed, without some adjustment in the contract price or some other term to compensate ratepayers for assuming this additional cost.

## 4. Specific Wording Changes to D.04-06-011 (As Modified by D.06-02-031 and D.06-09-021)

The Parties have agreed to clarify the PPA by adding a new Section 8.7 as follows:

8.7 Greenhouse Gas Emissions.

a. New Defined Terms. The following terms shall have the following meaning for purposes of this Agreement.

"GHG Limit" means the GHG Rate times the Maximum Gas Quantity associated with a Dispatch Notice.

"GHG Charges" has the meaning set forth in Section 8.7.b of this Agreement.

"GHG Rate" means the rate in pounds of $CO_2$ equivalent Greenhouse Gas emitted per MMBtu of natural gas combusted and, with respect to any particular GHG Charges, shall be equal to the rate adopted and/or applied by the Governmental

Authority that imposes the requirements resulting in such GHG Charges. For purposes of the cap-and-trade program approved by the California Air Resources Board ("CARB") on December 16, 2010 (Cal. Code Regs., tit. 17 §§ 95800 *et seq*.), the GHG Rate shall be equal to the rate calculated pursuant to CARB's Mandatory Reporting Rule (Cal. Code Regs., tit. 17, §§ 95100 *et seq*.) and the relevant sections incorporated therein of the United States Environmental Protection Agency's rule for Mandatory Greenhouse Gas Reporting (40 C.F.R. Part 98), as may be amended from time to time.

"Greenhouse Gas" means emissions into the atmosphere of gases that are regulated by one or more Governmental Authorities as a result of their contribution to the greenhouse effect heating of the surface of the earth. Greenhouse gases include carbon dioxide ($CO_2$), nitrous oxide ($N_2O$) and methane ($CH_4$), which are produced as the result of combustion or transport of fossil fuels. Other Greenhouse gases may include hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulfur hexafluoride ($SF_6$), which are generated in a variety of industrial processes. Greenhouse gases may be defined, or expressed, in terms of a ton of $CO_2$-equivalent, in order to allow comparison between the different effects of gases on the environment.

"Maximum Gas Quantity" means, for any Dispatch Notice, the quantity of Gas (expressed in MMBtu) equal to the sum of (i) the maximum quantity of Gas required for each CAISO settlement period of the Dispatch Notice, calculated by multiplying (a) the Delivered MWh's in such CAISO settlement interval by (b) the applicable Guaranteed Heat Rate; plus (ii) the Start-Up Fuel for each Start-Up in the relevant Dispatch Notice.

"Start-Up Fuel" means for each Start-up of a combustion turbine in a Dispatch notice, 11,000 MMBtu.

b. Greenhouse Gas Emissions Charges. Subject to the limitations and qualifications set forth below in this Section 8.7.b, Buyer shall reimburse Seller for taxes, charges, fees, or costs for, or resulting from, Greenhouse Gas (GHG Charges) attributable to a Dispatch Notice, within forty-five (45) days of Buyer's receipt from Seller of documentation reasonably establishing: (a) that Seller is actually liable for such GHG Charges as a result of operation of the Facility during the Delivery Term; (b) that such GHG Charge was not effective or scheduled to become effective as of the Effective Date; (c) the specific amount of such GHG Charge; (d) that such GHG Charge was imposed upon or incurred by Seller as a result of a requirement issued, enforced or otherwise implemented by an authorized Governmental Authority in whose jurisdiction the Facility is located, or which otherwise has jurisdiction over Seller or the Facility; (e) that Seller has paid the full amount of such GHG Charge for which Seller seeks reimbursement from Buyer under this Section 8.7, and (f) that Seller took all reasonable steps to mitigate the cost or amount of such GHG Charges, provided, the reasonable steps shall not be deemed to require Seller to make capital improvements to the Facility unless the Parties, after meeting and conferring in good faith, agree on an allocation between the Parties of the costs for such capital improvements.

   i. If Seller has the right to obtain allowances or credits attributed to the Facility to offset the GHG Charges for the Facility, then Seller shall utilize such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. Furthermore, if allowances or credits are not allocated to or otherwise provided for specific

generating units but Seller has the right to obtain allowances or credits attributed to its portfolio of generating units (all or some of the generating units owned, managed, or controlled by Seller), then Seller shall utilize a proportional amount of such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. If Seller is allocated or receives revenues, whether specific to each Facility or to Seller's portfolio of generating units, associated with any allowance or credit associated with Greenhouse Gas emissions attributable to a Dispatch Notice, then Seller shall remit any such revenue or, if allocated to Seller's portfolio of generating units, the proportional amount of such revenue, to Buyer to mitigate any GHG Charge that Buyer is responsible for hereunder. For the purposes of this Section 8.7.b.i, the proportional amount of allowances, credits, or revenues, as applicable, shall be calculated based on the historical annual Greenhouse Gas emissions (in terms of tons of $CO_2$-equivalent) of the Facility that would be subject to GHG Charges compared to the sum of the historical annual Greenhouse Gas emissions (in terms of tons of $CO_2$-equivalent) of all generating units within Seller's portfolio that would be subject to GHG Charges.

ii. If a Greenhouse Gas cap-and-trade scheme is adopted to control the emissions of Greenhouse Gases, where a Governmental Authority establishes a cap on the amount of Greenhouse Gases Greenhouse Gases that can be emitted and market participants, including generators, are issued or purchase emission allowances or credits representing the right to emit Greenhouse Gases in an aggregate amount equal to the cap, then the Parties intend that Buyer shall be responsible for acquiring the emission allowances or credits

associated with Greenhouse Gas emissions attributable to a Dispatch Notice, less any emission allowances or credits that Seller may have acquired and allocated to the Facility under Section 8.7.b.i above. Within a reasonable period after the enactment of such a Greenhouse Gas cap-and-trade scheme, the Parties shall cooperate and take commercially reasonable actions (including amending this Agreement as reasonably necessary, executing such documents or instruments as reasonably necessary, and complying with all applicable Law that address such Greenhouse Gas cap-and-trade scheme) to establish procedures to effectuate this intent; provided, however that the failure to agree on these procedures will not relieve the Parties of their respective obligations under this Agreement, and any failure to agree shall be resolved in accordance with the dispute resolution procedures in Article 20.

iii. Notwithstanding the foregoing, in no event shall Buyer be responsible for GHG Charges that exceed the GHG Limit or for GHG Charges that are attributable to any dispatch of the Facility that is not pursuant to a Dispatch Notice or a CAISO order to dispatch.

## 5. Comments on Proposed Decision

The proposed decision of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on November 15, 2012 from Panoche Energy Center LLC (PEC), and reply comments were filed on November 20, 2012 by SDG&E and Calpine. PEC also received permission to file a response to the replies and did so on November 26, 2012.

The draft PD denied PEC's motion for party status both because the motion was filed late and because PEC supported the relief sought by SDG&E in its uncontested petition for modification. However, PEC's comments have revealed that PEC has an interest in the rationale upon which the Commission bases its decision. Consequently, party status is hereby granted to PEC to file comments and reply comments.

In its comments, PEC requests removal of the discussion concerning the August 15, 2005 threshold date for considering whether parties to power purchase contracts could have foreseen the imposition of a carbon price in the electric sector. The August 15, 2005 version of AB 32 marked the first reference to a firm cap on emissions in AB 32. That version proposed adding Section 42877(a)(1) to the Health and Safety Code, which would have required the Secretary of the California Environmental Protection Agency to implement a "greenhouse gas emissions cap for the electrical power, industrial, and commercial sectors" by January 1, 2008. While this date is not singularly dispositive, it is relevant and may be considered along with other factors affecting the OMEC PPA and other similarly situated contracts. Thus, we decline to modify the proposed decision as requested.

## 6. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Robert Barnett is the assigned ALJ in this proceeding.

## Findings of Fact

1. Under the modified contract, SDG&E will be responsible for the Otay Mesa Plant's GHG compliance obligation attributed to SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant.

2. Allowances allocated to OMEC will be applied toward OMEC's compliance obligation.

3. All SDG&E costs under the PPA will be recoverable in rates.

4. OMEC's GHG responsibilities, attributed to SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant, will be allocated to SDG&E, and any allocation of GHG allowances received by OMEC will be used to meet OMEC's GHG compliance obligation.

5. The California GHG cap-and-trade program has been finalized. Once the program compliance begins on January 1, 2013, entities that emit more than 25,000 metric tons of carbon dioxide per year, such as OMEC, will have an obligation to acquire allowances in an amount equal to their emissions. At the same time, CARB will provide an allocation of allowances of over 6.9 million metric tons to SDG&E on behalf of its customers that it must place into the CARB auction in 2012 and 2013.

6. A clear allocation of GHG responsibilities was not specifically included in the original PPA or any of the subsequent PPA modifications because California's GHG regulatory regime was unknown at those times. SDG&E and OMEC have agreed that SDG&E should be responsible for acquiring allowances on behalf of Otay Mesa GHG in a beneficial holding arrangement, and that if OMEC receives any allocation of allowances, those allowances would be applied towards OMEC's GHG compliance obligation. The parties signed a letter agreement clarifying the PPA on September 21, 2011 for this purpose.

7. The proposed language in the letter agreement would compensate OMEC for actual GHG costs associated with its emissions up to a limit, akin to what was done in the AB 1613 contracts. The proposed language would also put OMEC's GHG compliance obligation into the hands of SDG&E. Such an arrangement

makes policy sense by ensuring that SDG&E's dispatch decisions reflect GHG costs.

8. Putting OMEC's GHG compliance obligation in SDG&E's hands is consistent with SDG&E's and California utilities' current approach to GHG costs.

9. The timing of the contract's execution in 2004 is an important consideration in the Commission's approval of this PFM.

10. The August 15, 2005 version of AB 32 marked the first reference to a firm cap on emissions in AB 32.

## Conclusion of Law

1. SDG&E is responsible for the Otay Mesa Plant's GHG compliance obligation attributed to SDG&E's dispatch of the Otay Mesa plant up to a limit based on the guaranteed heat rate of the Otay Mesa plant.

2. Any allowances allocated to OMEC will be applied toward OMEC's compliance obligation.

3. All SDG&E costs under the PPA will be recoverable in rates.

4. The petition should be granted.

5. The motion of PEC for party status is granted to allow PEC to file opening and reply comments to the proposed decision.

## O R D E R

**IT IS ORDERED** that:

1. The November 16, 2011 petition of San Diego Gas & Electric Company to modify Decision (D.) 04-06-011 (as modified by D.06-02-031 and D.06-09-021) is granted.

2. Rulemaking 01-10-024 is closed.

This order is effective today.

Dated December 20, 2012, at San Francisco, California.

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK J. FERRON
Commissioners

# APPENDIX A

SDGE
A Sempra Energy utility®

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September 21 , 2011

Otay Mesa Energy Center, LLC
717 Texas Avenue
Houston, TX 94568-3139
Attn: Chief Legal Officer

Otay Mesa Energy Center, LLC
4160 Dublin Blvd., Suite 100
Dublin, CA 94568
Attn: Vice President, West Operation

Re: Greenhouse Gas Compliance Costs

Dear Mr. Makler:

Reference is made to that certain Amended and Restated Power Purchase Agreement, dated as of May 1, 2007 (the "Agreement"), by and between San Diego Gas & Electric Company, a California corporation ("Buyer") and Otay Mesa Energy Center, LLC, a Delaware limited liability company ("Seller"). Capitalized terms used herein but not otherwise defined herein shall have the meanings given in the Agreement.

Although the nature of forthcoming regulatory requirements concerning emissions of carbon dioxide and other greenhouse gases has yet to be finally determined (*e.g.*, cap and trade instead of a carbon tax, or vice versa), the Parties believe it is prudent to provide certainty with respect to how certain greenhouse gases compliance costs shall be addressed under the Agreement. Accordingly, in consideration of the mutual promises and agreements set forth herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Buyer and Seller, intending to be legally bound, hereby enter into this letter agreement ("Letter Agreement") concerning greenhouse gas compliance costs.

It shall be a condition precedent to the effectiveness of this Letter Agreement that no later than March 1, 2012, Buyer shall have received a final and non-appealable order from the CPUC (i) approving the terms and conditions of this Letter Agreement without material alteration of the commercial aspects described herein, and (ii) finding Buyer's entry into this Letter Agreement is reasonable and that payments to be made by Buyer hereunder are recoverable in rates, subject to CPUC review of the Buyer's administration of this Letter Agreement. If the foregoing CPUC order is not obtained on or before the deadline date therefor, then this Letter Agreement shall have no force and effect. Prior to such deadline date, Buyer shall use commercially reasonable efforts to seek such CPUC order through a Petition for Modification of the CPUC's Decision No. 06-09-021. Buyer shall provide Seller an opportunity to review and comment on the Petition for Modification seven days prior to its filing. Buyer shall file the Petition for Modification within

thirty days after both Parties execute this Letter Agreement. Subject to satisfaction of this condition precedent, the Parties hereby agree to amend the Agreement by adding a new Section 8.7 as follows:

**8.7.** Greenhouse Gas Emissions.

a. New Defined Terms. The following terms shall have the following meaning for purposes of this Agreement.

"GHG Limit" means the GHG Rate times the Maximum Gas Quantity associated with a Dispatch Notice.

"GHG Charges" has the meaning set forth in Section 8.7.b of this Agreement.

"GHG Rate" means the rate in pounds of $CO_2$ equivalent Greenhouse Gas emitted per MMBtu of natural gas combusted and, with respect to any particular GHG Charges, shall be equal to the rate adopted and/or applied by the Governmental Authority that imposes the requirements resulting in such GHG Charges. For purposes of the cap and trade program approved by the California Air Resources Board ("CARB") on December 16, 2010 (Cal. Code Regs., tit. 17 §§ 95800 *et seq.*), the GHG Rate shall be equal to the rate calculated pursuant to CARB's Mandatory Reporting Rule (Cal. Code Regs., tit. 17, §§ 95100 *et seq.*) and the relevant sections incorporated therein of the United States Environmental Protection Agency's rule for Mandatory Greenhouse Gas Reporting (40 C.F.R. Part 98), as may be amended from time to time.

"Greenhouse Gas" means emissions into the atmosphere of gases that are regulated by one or more Governmental Authorities as a result of their contribution to the greenhouse effect heating of the surface of the earth. Greenhouse gases include carbon dioxide ($CO_2$), nitrous oxide ($N_2O$) and methane ($CH_4$), which are produced as the result of combustion or transport of fossil fuels. Other greenhouse gases may include hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulfur hexafluoride ($SF_6$), which are generated in a variety of industrial processes. Greenhouse gases may be defined, or expressed, in terms of a ton of $CO_2$-equivalent, in order to allow comparison between the different effects of gases on the environment.

"Maximum Gas Quantity" means, for any Dispatch Notice, the quantity of Gas (expressed in MMBtu) equal to the sum of (i) the maximum quantity of Gas required for each CAISO settlement period of the Dispatch Notice, calculated by multiplying (a) the Delivered MWh's in such CAISO settlement interval by (b) the applicable Guaranteed Heat Rate; plus (ii) the Start-Up Fuel for each Start-Up in the relevant Dispatch Notice.

"Start-Up Fuel" means for each Start-up of a combustion turbine in a Dispatch notice, 11,000 MMBtu.

b. Greenhouse Gas Emissions Charges. Subject to the limitations and qualifications set forth below in this Section 8.7.b, Buyer shall reimburse Seller for taxes, charges, fees, or costs for, or resulting from, Greenhouse Gas ("GHG Charges") attributable to a Dispatch Notice, within forty-five (45) days of Buyer's receipt from Seller of documentation reasonably establishing: (a) that Seller is actually liable for such GHG Charges as a result of

operation of the Facility during the Delivery Term; (b) that such GHG Charge was not effective or scheduled to become effective as of the Effective Date; (c) the specific amount of such GHG Charge; (d) that such GHG Charge was imposed upon or incurred by Seller as a result of a requirement issued, enforced or otherwise implemented by an authorized Governmental Authority in whose jurisdiction the Facility is located, or which otherwise has jurisdiction over Seller or the Facility; (e) that Seller has paid the full amount of such GHG Charge for which Seller seeks reimbursement from Buyer under this Section 8.7, and (f) that Seller took all reasonable steps to mitigate the cost or amount of such GHG Charges, provided, the reasonable steps shall not be deemed to require Seller to make capital improvements to the Facility unless the Parties, after meeting and confering in good faith, agree on an allocation between the Parties of the costs for such capital improvements.

i. If Seller has the right to obtain allowances or credits attributed to the Facility to offset the GHG Charges for the Facility, then Seller shall utilize such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. Furthermore, if allowances or credits are not allocated to or otherwise provided for specific generating units but Seller has the right to obtain allowances or credits attributed to its portfolio of generating units (all or some of the generating units owned, managed, or controlled by Seller), then Seller shall utilize a proportional amount of such allowances or credits to mitigate any GHG Charge hereunder resulting from a Dispatch Notice. If Seller is allocated or receives revenues, whether specific to each Facility or to Seller's portfolio of generating units, associated with any allowance or credit associated with Greenhouse Gas emissions attributable to a Dispatch Notice, then Seller shall remit any such revenue or, if allocated to Seller's portfolio of generating units, the proportional amount of such revenue, to Buyer to mitigate any GHG Charge that Buyer is responsible for hereunder. For the purposes of this Section 8.7.b.i, the proportional amount of allowances, credits, or revenues, as applicable, shall be calculated based on the historical annual Greenhouse Gas emissions (in terms of tons of $CO_2$-equivalent) of the Facility that would be subject to GHG Charges compared to the sum of the historical annual Greenhouse Gas emissions (in terms of tons of $CO_2$-equivalent) of all generating units within Seller's portfolio that would be subject to GHG Charges.

ii. If a Greenhouse Gas cap and trade scheme is adopted to control the emissions of Greenhouse Gases, where a Governmental Authority establishes a cap on the amount of Greenhouse Gases that can be emitted and market participants, including generators, are issued or purchase emission allowances or credits representing the right to emit Greenhouse Gases in an aggregate amount equal to the cap, then the Parties intend that Buyer shall be responsible for acquiring the emission allowances or credits associated with Greenhouse Gas emissions attributable to a Dispatch Notice, less any emission allowances or credits that Seller may have acquired and allocated to the Facility under Section 8.7.b.i above. Within a reasonable period after the enactment of such a Greenhouse Gas cap and trade scheme, the Parties shall cooperate and take commercially reasonable actions (including amending this Agreement as reasonably necessary, executing such documents or instruments as reasonably necessary, and complying with all applicable Law that address such Greenhouse Gas cap and trade scheme) to establish procedures to effectuate this intent; provided, however that the failure to agree on these procedures will not relieve the Parties of their respective obligations under this Agreement, and any failure to agree shall be resolved in accordance with the dispute resolution procedures in Article 20.

iii. Notwithstanding the foregoing, in no event shall Buyer be responsible for GHG Charges that exceed the GHG Limit or for GHG Charges that are

attributable to any dispatch of the Facility that is not pursuant to a Dispatch Notice or a CAISO order to dispatch.

Except as set forth expressly herein, each of Buyer and Seller agrees that nothing in this Letter Agreement shall be construed as amending, supplementing, impairing or otherwise modifying any representation, warranty, agreement, indemnity or other obligation set forth in any other agreement executed and delivered in connection with the Agreement or the Facility.

This Letter Agreement shall be binding upon and shall inure to the benefit of each of Buyer and Seller and its respective successors, assigns and other transferees. This Letter Agreement may not be assigned by either party except in connection with a permitted assignment of the Agreement. All parties hereto represent and warrant that they have all requisite power and authority to enter into this Letter Agreement, that this Letter Agreement is enforceable in accordance with its terms, and that no further consents are required to give effect to the matters agreed herein. This Letter Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. This Letter Agreement shall be governed by, and construed in accordance with, the laws of the State of California.

Please indicate your agreement to the terms and conditions of this Letter Agreement by executing the appropriate acknowledgment below.

Sincerely,

SAN DIEGO GAS & ELECTRIC COMPANY

By: _____
Name: Michael R. Niggli
Title: President & COO

The undersigned acknowledges and consents to the foregoing.

OTAY MESA ENERGY CENTER, LLC
a Delaware limited liability company

By: _____
Name: Alexandre Makler
Title: Vice President

**(END OF APPENDIX A)**